



TC06765

Appeal number: TC/2017/01640

VAT default surcharge - cash flow shortage - logistical problems caused delays in delivery of goods to customers - whether reasonable excuse for late payment - on the facts, yes - whether a request for time to pay had been considered by HMRC - no - whether reasonable excuse - yes - Appeal allowed

**FIRST-TIER TRIBUNAL
TAX CHAMBER**

CHAMELEON TECHNOLOGY (UK) LIMITED Appellant

- and -

**THE COMMISSIONERS FOR HER MAJESTY'S Respondents
REVENUE & CUSTOMS**

**TRIBUNAL: JUDGE: MICHAEL CONNELL
MEMBER: ANN CHRISTIAN**

Sitting in public at City Exchange, Albion Street, Leeds on 23 April 2018

Mr Graeme Allison, Finance Director of the Appellant Company

Mr Gareth Hilton, Officer of HMRC, for the Respondents

DECISION

The Appeal

1. Chameleon Technology (UK) Limited (“the Appellant”) appeals against a VAT default surcharge of £17,599.56, for its failure to submit in respect of its VAT period 07/16, by the due date, payment of VAT due. The surcharge was calculated at 10% of the VAT due of £175,995.60
2. The point at issue is whether the Appellant has a reasonable excuse for making the late payment.

10 **Background**

3. The Appellant registered for VAT in January 2011 and has the VAT Registration Number 102 9983 08. The nature of the business is the development, manufacture and supply of energy smart meters.
4. The Appellant has been in the default surcharge regime from Period 07/15 onwards.
5. The Appellant has been mandated to both render returns and pay the tax due electronically under Reg 25A VAT Regulations 1995.
6. The Appellant paid VAT on a quarterly basis. Section 59 of the VAT Act 1994 requires a VAT return and payment of VAT due, on or before the end of the month following the relevant calendar quarter. [Reg 25(1) and Reg 40(1) VAT Regulations 1995].
7. HMRC have discretion to allow extra time for both filing and payment when these are carried out by electronic means [VAT Regulations 1995 SI 1995/2518 regs 25A (20), 40(2)]. Under that discretion, HMRC allow a further seven days for filing and payment.
8. Section 59 Value Added Tax Act 1994 (“VATA”) sets out the provisions in relation to the default surcharge regime. Under s 59(1) a taxable person is regarded as being in default if he fails to make his return for a VAT quarterly period by the due date or if he makes his return by that due date but does not pay by that due date the amount of VAT shown on the return. The Commissioners may then serve a surcharge liability notice on the defaulting taxable person, which brings him within the default surcharge regime so that any subsequent defaults within a specified period result in assessment to default surcharges at the prescribed percentage rates. The specified percentage rates are determined by reference to the number of periods in respect of which the taxable person is in default during the surcharge liability period. In relation to the first default the specified percentage is 2%. The percentage ascends to 5%, 10% and 15% for the second, third and fourth default.

9. Period 07/15 had a due date of 7 September 2015 for electronic VAT Returns and Payments. The VAT Return was received before the due date on 24 August 2015. The Appellant paid their VAT due by way of three payments. The First Payment was received on 11 September 2015, the second on 9 October 2015 and the final payment was received on 11 November 2015. As a result of the VAT payments being received after the due date, a Surcharge Liability Notice was issued.

10. Period 10/15 had a due date of 7 December 2015 for electronic VAT Returns and Payments. The VAT Return was received before the due date on 2 December 2015. The Appellant paid their VAT by way of a Telephone Payment transaction which was received after the due date on 11 December 2015. As a result of the late VAT payment a Surcharge Liability Notice Extension was issued at 2%. As the default surcharge was less than £400, HMRC did not impose a financial penalty.

11. In period 01/16 the Appellant was compliant.

12. Period 04/16 had a due date of 7 June 2016 for electronic VAT Returns and Payments. The VAT Return was received before the due date on 31 May 2016. The amount due was £132,169. Payment was not made on time. As a result of the VAT payment being received late, a Surcharge Liability Notice Extension was issued at 5% of the sum due of £132,169.62, amounting to £6,608.48. The Appellant paid the VAT by way of three payments. Two payments totalling £69,389 were received on 12 August 2016. On 7 July 2016 the Appellant had promised that the final payment of £62,780 would be made on 26 August 2016 and HMRC's notes record that a TTP was agreed to that effect. In the event, payment was not made until 16 September 2016.

13. Period 07/16 had a due date of 7 September 2016 for electronic VAT Returns and Payments. The VAT Return was received before the due date on 31 August 2016. The VAT due was £205,995.56.

14. On 7 September 2016 the Appellant paid £30,000 (on time). On 9 September 2016, after the due date, the Appellant requested Time to Pay the VAT due. HMRC agreed to staged payments (not a time to pay arrangement). The Appellant paid the balance due by three further payments of £95,000 on 16 September, £50,000 and £30,995.66 on 7 October 2016.

15. Mr Graeme Allisson, the Company's Finance Director says that on a number of occasions in August and early September 2016 he telephoned HMRC to discuss a TTP for VAT due in respect of 07/16. He was not able to speak to anyone and therefore left messages asking for a return call.

16. On 16 September 2017, HMRC issued a default surcharge assessment to the Appellant in the sum of £20,599.56 calculated at the 10% rate due to three previous defaults.

17. HMRC subsequently agreed to reduce the surcharge to £17,599.56 because £30,000 had been paid in time.

18. HMRC maintain s 108 Finance Act 2009 specifies that there is no liability to a default surcharge for a period where contact is made with HMRC prior to the due date in order to arrange Time to Pay. Because the Appellant did not make any arrangements prior to the due date for the period 07/16, the surcharge position is unaffected by this section.

19. The Appellant paid the balance of VAT by way of staged payments. HMRC's policy is that it is in the Appellant's interest that payments continue to be accepted by HMRC without prejudice, while it considers recovery action or referral to their Enforcement Insolvency Service.

20. A taxable person who is otherwise liable to a default surcharge, may nevertheless escape that liability if he can establish that he has a reasonable excuse for the late payment which gave rise to the default surcharge(s). Section 59 (7) VATA 1994 sets out the relevant provisions : -

'(7) If a person who apart from this sub-section would be liable to a surcharge under sub-section (4) above satisfies the Commissioners or, on appeal, a Tribunal that in the case of a default which is material to the surcharge -

(a) the return or as the case may be, the VAT shown on the return was despatched at such a time and in such a manner that it was reasonable to expect that it would be received by the commissioners within the appropriate time limit, or

(b) there is a reasonable excuse for the return or VAT not having been so despatched then he shall not be liable to the surcharge and for the purposes of the preceding provisions of this section he shall be treated as not having been in default in respect of the prescribed accounting period in question ..'

21. Section 59(7) must be applied subject to the limitation contained in s 71(1) VATA 1994 which provides as follows:

'(1) For the purposes of any provision of section 59 which refers to a reasonable excuse for any conduct any insufficiency of funds to pay any VAT due is not a reasonable excuse.'

22. Although an insufficiency of funds to pay any VAT due is not a reasonable excuse, case law has established the principle that the underlying cause of any insufficiency of funds may constitute a reasonable excuse

23. On 6 December 2016, at the request of the Appellant, the decision to impose a penalty was reviewed by HMRC but upheld.

24. On 9 February 2017 the Appellant lodged a Notice of Appeal with the Tribunal Service. It is s 59(7)(b) VATA on which the Appellant seeks to rely.

23. The initial onus of proof rests with HMRC to show that a surcharge has been correctly imposed. If so established, the onus then rests with the Appellant to

demonstrate that there was a reasonable excuse for late payment of the tax. The standard of proof is the ordinary civil standard on a balance of probabilities.

Appellant's Case

5 25. The Appellant does not dispute that its VAT payments for the periods under appeal were late, but says that a request for a TTP was not considered by HMRC.

26. The Appellant says that cash flow shortages were caused by unforeseeable events beyond their control and they made every effort to agree a TTP prior to the due date of 7 September 2016.

10 27. The Appellant says that if they had been able to discuss their cash flow position with HMRC in August or early September 2016, as they attempted, then they would in all likelihood have agreed a payment plan with HMRC and the surcharge would not have been chargeable.

15 28. In a letter to HMRC of 11 October 2016, Mr Michael Woodhall the Managing Director of the Company set out the reasons for cash flow shortages in August and early September 2016. He explained that the Company is a supplier of electronic energy displays to major utilities within the UK as part of the smart meter rollout program. They manufacture their products in China and have a logistics and supply chain which takes around three months to secure and manufacture the product. Once the products are ready for despatch they look to arrange transportation either by air or sea for delivery to the customer in the UK.

20 29. Mr Woodhall explained that they had over the period March - September 2016 seen a significant increase in the number of units ordered by customers at short notice and as such this had seen them use air freight far more than would have normally been the case. Their invoicing profile is that they only deliver in one off large quantities and consequently they only have cash available when the goods are delivered to the customer because it is only at that point that they receive payment via their invoice finance facility which funds 80% of the working capital of the business.

25 30. He said that the Company had planned for deliveries during August and September 2016, which if they had gone according to plan, would have seen the Company have no issue with cash flow/working capital. Unfortunately, two major logistical problems occurred, which meant that their cash flow receipts moved out by a number of weeks and therefore caused the Company's inability to pay VAT in line with deadlines.

30 31. Mr Woodhall said that the first problem was Typhoon Nida, a severe tropical cyclone that struck Luzon, Philippines and Guangdong, China in late July and early August respectively. This caused the manufacturing factory in China as well as the supply chain feeding the factory with parts, to shut down for a number of days in early August. This caused significant delays to the supply chain and production of their goods, which were due to be delivered during August 2016.

32. The second issue was the launch of the I-phone 7 from Apple in early September 2016. Apple had block booked air freight flights which created a shortage of availability into the UK from China for the first two weeks of September 2016. This again moved the Company's delivery schedule back by a number of weeks.

- 5 33. Mr Woodhall supplied a chart to show the effect on the Company's turnover and working capital:

	AUGUST 2016	SEPTEMBER 2016	TOTAL
Turnover – Actual	£399,840	£2,393,414	£2793254
Turnover - Budget	£1076,612	£948,987	£2,025,599
Variance	(£676,772)	£1,444,427	£767,655

- 10 34. As a result of the cash flow problems, the Appellant company's turnover in August 2016 was reduced from an expected £1 million to £400,000, whereas the company's cash flow September was £1.4 million over budget.

- 15 35. Mr Woodhall added that when they became aware of, firstly the effect of Typhoon Nida and the potential effect on their deliveries and cash flow, they contacted HMRC. The Finance Director, Mr Allison, telephoned on 7 and 12 August 2016 and tried to speak to the Company's case manager Mrs Lesley Liddle to explain the position. He also twice telephoned HMRC's late payment department and was told each time that they were unable to speak to him as the Company's case was being dealt with by their case manager, Mrs Liddle, as they were still in a short term 'time to pay arrangement' for their VAT from the previous 04/16 quarter. Mr Allison says he left messages on a number of occasions but was unable to make contact with Mrs Liddle.

36. The second delivery issue regarding the I-phone 7 launch further delayed their cash availability until later into September 2016.

- 25 37. The Appellant feels that the Company was not given the opportunity to discuss this with HMRC. Had they been able to explain the issues and exceptional circumstances that were affecting them, they may not have been issued with the VAT surcharge. However that opportunity was never made available to them.

- 30 38. At the hearing Mr Allison said that normally they would have been able to extend their factoring facilities, but the problems created by Typhoon Nida came about too suddenly, as the factoring agent required at least four weeks' notice of any changes to payment plans. For similar reasons it was not possible to arrange a short-term overdraft. The Chinese manufacturers had insisted that prior to commencing manufacturing of the smart meters, they required payment of cash deposits which took up all of the Appellant's available capital.

39. The Company is now up to date with its VAT and other tax payments.

HMRC's Case

40. Mr Hilton for HMRC said that the onus of proof rests with HMRC to demonstrate that a penalty is due. Once so established, the onus is then on the Appellant to demonstrate that there is a reasonable excuse for late payment. The standard of proof is the ordinary civil standard, which is the balance of probabilities.

41. There is a statutory obligation on a person required to make a return, to pay the VAT to HMRC. Value Added Tax Regulations 1995, at Regulation 40, state that any person required to make a return "shall pay" to HMRC "such amount of VAT as is payable by him in respect of the period to which the return relates not later than the last day on which he is required to make that return."

42. Period 07/16 had a due date of 7 September 2016 for electronic VAT Returns and Payments. The Appellant's VAT Return was received on 7 September 2016. The Appellant paid their VAT by way of four payments, three of which were late. The surcharge has been correctly issued in accordance with the VAT Act 1994 s 59(4).

43. The first default was recorded for period 07/15 and the Appellant entered the Default Surcharge regime. The potential financial consequences attached to the risk of further default would have been known to the Appellant from this point onward, given the information printed on the Surcharge Liability Notice issued.

44. The potential financial consequences attached to the risk of further defaults would have been known to the Appellant after issue of the Surcharge Liability Notice for period 07/15, when a Surcharge Liability Notice was issued, particularly given the information contained in the Notice which on the reverse states:

'Please remember your VAT returns and any tax due must reach HMRC by the due date. If you expect to have any difficulties contact either your local VAT office, listed under HM Revenue & Customs in the phone book as soon as possible, or the National Advice Service on 0845 010 9000.'

45. Given the default history and information available, the Appellant would have been aware of the potential fiscal consequence of a further default prior to the period subject to appeal.

46. The requirements for submitting timely electronic payments can also be found -

- In notice 700 "the VAT guide" paragraph 21.3.1 which is issued to every trader upon registration.
- On the actual website www.hmrc.gov.uk
- On the E-VAT return acknowledgement.

47. Also, the reverse of each default notice details how surcharges are calculated and the percentages used in determining any financial surcharge in accordance with the VAT Act 1994 s 59(5).

48. The Appellant states if they were able to discuss their position with HMRC in August, then HMRC would have agreed a payment plan and the surcharge may not have been charged. HMRC maintain that the Appellant had requested a Time to Pay arrangement for the previous quarters, Periods 01/16 and 04/16. A Time to Pay agreement is designed to be a short term solution to enable the Appellant to get over a short term financial difficulty, not a method of making continuous late payments.

49. For the Period 04/16 the final payment of £62,780.57 was paid on 16 September 2016. As this debt was still outstanding at the due date for Period 07/16 on 7 September 2016, the Appellant should not have had any expectations that HMRC would have renegotiated a TTP agreement.

50. HMRC's notes of telephone calls show that the Appellant's telephone call on 5 August 2016 was referred to the Field Force officer as they were not making a payment for the Time to Pay Arrangement that was in place at that time (Period 04/16). The telephone call of 12 August 2016 shows that the Appellant phoned to make a payment of half the balance outstanding for 04/16.

51. For Period 07/16, it can be seen from HMRC's notes of a telephone call on 23 September 2016 that the Appellant phoned and requested a Time to Pay arrangement, which was agreed. As this was after the due date the surcharge position is unaffected by s 108 Finance Act 2009.

52. The Appellant would have received payment from their Invoice Factoring Company prior to the due date. The monies would therefore be available to the business to meet its VAT obligations. If the business chose to treat this as an interest free loan until the VAT became payable, but which was not available at the due date due to cash flow problems, that is a risk the business took upon itself and cannot be used a reasonable excuse.

53. The Appellant's VAT Return for Period 07/16 shows the total value of sales excluding VAT as £2,156,490. The Appellant would have received sufficient funds via their finance company to pay the VAT due of £205,995.66.

54. HMRC sympathises with the position the Company found itself in with regards to Typhoon Nida and the problems encountered in reserving air freight transport. The cash flow problems were neither new nor sudden as demonstrated by the Appellant's need to request a Time to Pay arrangement for three consecutive periods. The events of August and September cannot be considered a reasonable excuse for the late payment of VAT for the Period 07/16.

55. Lord Justice Nolan comments in his judgement in *Salevon: (Commissioners of Customs and Excise v Salevon* [1989] STC 907):

"...the cases in which a trader with insufficient funds to pay the tax can successfully invoke the defence of "reasonable excuse" must be rare. That is because the scheme of collection which I have outlined involves at the outset the trader receiving (or at least being entitled to receive) from his customers the amount of tax which he must subsequently pay over to the commissioners. There is nothing in law to prevent him

5 from mixing this money with the rest of the funds of his business and using it for normal business expenses (including the payment of input tax), and no doubt he has every commercial incentive to do so. The tax which he has collected represents, in substance, an interest-free loan from the commissioners. But by using it in his business he puts it at risk. If by doing so he loses it, and so cannot hand it over to the commissioners when the date of payment arrives, he will normally be hard put to it to invoke a. s19 (6) (b). In other words he will be hard put to it to persuade the commissioners or the tribunal that he had a reasonable excuse for venturing and thus losing money destined for the Exchequer of which he was the temporary custodian.”

10 56. The Appellant has not provided any grounds that can be considered a reasonable excuse for the late payment of VAT for Period 07/16. A prudent and competent business person would have put measures in place to ensure that the VAT money was available to the business to meet its VAT obligations. If the business chose to treat this as an interest free loan until the VAT became payable, but which was not
15 available at the due date due to cash flow problems, that is a risk the business took upon itself and cannot be used a reasonable excuse.

Conclusion

20 57. The proprietors of the Appellant Company were clearly aware of the due date for payments of its VAT and the potential consequences of late payment. Their grounds of appeal are that they did not carelessly or recklessly neglect their obligations. Instead, unforeseeable events beyond their control created severe cash flow problems which caused the defaults.

25 58. In considering whether the Appellant had a reasonable excuse for the late payment of VAT due in period 07/16, although the primary cause was an insufficiency of funds which is specifically excluded by s 71 VATA as being a reasonable excuse, it is necessary to consider the underlying causes of the insufficiency of funds.

59. In the Court of Appeal decision of *Customs and Excise Commissioners v Steptoe* [1992] STC 757 (“*Steptoe*”) Lord Donaldson MR said:

30 “if the exercise of reasonable foresight and of due diligence and a proper regard for the fact that the tax would become due on a particular date would not have avoided the insufficiency of funds which led to the default, then the taxpayer may well have a reasonable excuse for non-payment, but that excuse will be exhausted by the date on which such foresight, diligence and regard would have overcome the insufficiency of funds.”

35 60. He went on to disapprove of a narrower test put forward by Scott LJ (based on the reasoning of Nolan LJ in *Salevon*) and emphasised the importance of ascertaining whether the late payment of VAT arose because of reasons which were inescapable or reasonably avoidable:

40 “Scott LJ.... Is of the opinion that the underlying cause of the insufficiency of funds must be an ‘unforeseeable or inescapable event’. I have come to the conclusion that this is too narrow in that (a) it gives insufficient weight to the concept of reasonableness and (b) it treats foreseeability as relevant in its own right, whereas I think that

‘foreseeability’ or as I would say ‘reasonable foreseeability’ is only relevant in the context of whether the cash flow problem was ‘inescapable’ or as I would say, ‘reasonably avoidable’. It is more difficult to escape from the unforeseeable than from the foreseeable.”

5 61. To decide whether a reasonable excuse exists, the Tribunal should ask itself, whether, notwithstanding the proprietor’s exercise of reasonable foresight, due diligence and a proper regard for the fact that the tax would become payable on the particular date, they would not have avoided the default which occurred.

10 62. Having considered the background facts and circumstances leading up to the default, the reason for the late payment were two unforeseeable and unexpected events outside the Company’s control. It is clear from the facts that the Appellant had done everything it could to exercise reasonable foresight, due diligence and have due regard for the fact that its VAT was payable on the due date. It had in place invoice discounting facilities, and an overdraft with its bankers. The company enjoyed no
15 credit facilities with its suppliers. In the midst of these everyday problems it suffered two unforeseeable and significant cash flow interruptions.

20 63. It is also clear from the fact that the Appellant cleared the VAT balance due for 07/16 of £175,995.56 (by payments of £95,000 on 16 September, £50,000 and £30,995.66 on 7 October 2016 within just three weeks) that their cash flow problem was very short term. Their problems were not one of liquidity, but logistics. The projected time frame between taking delivery of goods in China and making payment on the one hand, and receipt of monies from their factoring agent, and delivery to the customer in the UK on the other, was extended by a month which caused the cash flow problems.

25 64. In turn, had HMRC given the Appellant’s request for a Time To Pay due and full consideration, an arrangement would or should have been put in place. For reasons which are not clear, the necessary dialogue did not happen, but given the fact that the Appellant cleared a substantial amount of outstanding VAT very quickly we have to accept that the Appellant had every incentive to agree an arrangement with HMRC.
30 There would be no reason for them not to do so. HMRC were of course under no obligation to agree time to pay but the fact that the issue was never discussed due to no fault on the part of the Appellant is in itself also a reasonable excuse.

35 65. The Appellant has therefore shown a reasonable excuse for its late payment of VAT for the 07/16 period. The appeal is accordingly allowed and the surcharge of £17,599.56 discharged.

66. This document contains full findings of fact and reasons for the decision. Any party dissatisfied with this decision has a right to apply for permission to appeal against it pursuant to Rule 39 of the Tribunal Procedure (First-tier Tribunal) (Tax Chamber) Rules 2009. The application must be received by this Tribunal not later than 56 days after this decision is sent to that party. The parties are referred to “Guidance to accompany a Decision from the First-tier Tribunal (Tax Chamber)” which accompanies and forms part of this decision notice.

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**MICHAEL CONNELL
TRIBUNAL JUDGE**

RELEASE DATE: 12 October 2018